REPORT BY THE

Comptroller General

OF THE UNITED STATES

Questions Continue As To Prices In Contracting For Architectural-Engineering Services Under The Environmental Protection Agency Construction Grants Program

Over 2 years ago the Environmental Protection Agency issued regulations prohibiting contracts to those engineering firms which base profits on construction costs. The regulations require grantees to negotiate contract terms with the contractor. Many grantees lack negotiating experience, however, and Agency reviews of the contracts are insufficient for several reasons discussed in the report.

Many engineering contracts awarded before the effective date of the regulations and based on the now prohibited methods of fee determination are still in effect. No legal basis exists to require that many of these contracts be renegotiated.

This review was undertaken at the request of the former Chairman, Subcommittee on Investigations and Review, House Committee on Public Works and Transportation.

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JUNE 6, 1978

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-166506

The Honorable Ronald Bo Ginn
Chairman, Subcommittee on
Investigations and Review
Committee on Public Works and
Transportation
House of Representatives

Dear Mr. Chairman:

As requested by the former Subcommittee Chairman, we reviewed certain matters concerning procurement of architectural-engineering services under grants awarded by the Environmental Protection Agency for construction of waste treatment works.

This report addresses problems that arose in the Agency's implementation of new regulations covering grantee procurement of architectural-engineering services. The report also discusses the prevalence of percentage-of-cost type contracts for architectural-engineering services before the Environmental Protection Agency prohibited such contracts, effective July 1, 1975, and the Agency's legal authority to require that active contracts of this type be renegotiated.

We did not obtain written agency comments. The matters discussed in the report, however, were discussed with agency officials, and their comments are incorporated where appropriate.

As arranged with your office, we are sending copies of this report to Congressmen James Wright and Jerome A. Ambro; the Administrator, Environmental Protection Agency; and other interested parties. Copies will also be available to others upon request.

Sincerely yours,

Comptroller General
of the United States

REPORT OF THE
COMPTROLLER GENERAL
OF THE UNITED STATES

QUESTIONS CONTINUE AS TO PRICES IN CONTRACTING FOR ARCHITECTURAL-ENGINEERING SERVICES UNDER THE ENVIRONMENTAL PROTECTION AGENCY CONSTRUCTION GRANTS PROGRAM

D I G E S T

Many contract weaknesses continue even though some contracts, such as cost-plus-a-percentage-of-cost, or a percentage-of-construction-costs, no longer are being used when communities contract for architectural-engineering services under the Environmental Protection Agency construction grants program. These weaknesses raise questions as to the reasonableness of prices obtained. Problems include the following.

--Many communities and the Environmental Protection Agency lack sufficient expertise for reviewing cost and pricing data submitted by engineers.

--Agency and grantee reviews of procurement actions are inadequate.

--The Agency lacks clear profit guidelines to use for evaluating cost and price proposals.

In addition, many contracts containing now-prohibited contracting methods still are in effect. The Agency does not have authority to require that some of these contracts be renegotiated. Moreover, Agency officials believe costs of renegotiation could have resulted in increased, rather than decreased, contract prices.

Environmental Protection Agency officials told GAO that the Agency and grantees rely almost entirely on data submitted by architectural-engineering firms. Further, architectural-engineering firms are allowed to carry out projects with little or no control by the grantees, according to these officials. Many grantees have little knowledge of projects. Thus, grantees have little opportunity to assess the reasonableness of costs charged by the engineering firms, these officials added. (See pp. 4, 5, and 14.)

Agency regional offices are responsible for reviewing contracts awarded by communities in their areas; however, many contracts are not reviewed. For those contracts that are reviewed, the review is limited and varies from region to region. Currently, only contracts of over $100,000 are reviewed as a rule.

The Agency has not defined procedures clearly to assure that adequate and consistent reviews are made. Since most contracts are for $100,000 or less, they are usually not reviewed. Grantees are responsible for reviewing contracts but most do not have the capability, and the Agency has not provided them with guidance to use in reviewing contracts of $100,000 or less.

There is a lack of clear guidelines defining a fair and reasonable profit for noncompetitive contracts for architectural-engineering services. Consequently, estimated profit percentages agreed to in architectural-engineering contracts vary greatly among the Agency's regions. The Agency's Office of Audit found that negotiated profit margins ranged from 5 to 35 percent, and fees ranged from 7 to 19 percent of proposed costs in 56 contracts it audited. Thus, Agency control of profits for architectural-engineering services depends on regional concepts of fairness, which vary, and upon adequacy of contract reviews, which is limited. (See pp. 6 and 9.)

Under new regulations, certain architectural-engineering fee-setting practices were prohibited because they encouraged increasing costs rather than cost controls. Many contracts containing these provisions are still active. The Agency, however, does not have authority to require that many of these contracts be renegotiated. Firms have voluntarily renegotiated their contracts, but such action has been infrequent. (See pp. 14 and 15.)

The Environmental Protection Agency Administrator should

--develop guidelines for grantees to use in reviewing architectural-engineering contract proposals of $100,000 or less;

--emphasize to grantees that hiring of personnel to do cost reviews is permitted under the regulations and is an allowable cost;

--revise the Agency's regulations to clearly define the procedures for reviewing architectural-engineering contracts over $100,000;

--develop and issue guidance on fair and reasonable profits to be allowed in architectural-engineering contracts; and

--develop a program to review contracts under $100,000 on a selected basis, to determine the adequacy of grantee reviews of proposals and to periodically revise guidelines developed for proposal reviews, if necessary. (See p. 11.)

AGENCY COMMENTS

The Agency agreed that more guidance is needed to assure that architectural-engineering services are obtained at fair and reasonable prices. The Agency indicated it would be difficult to implement the recommendations, however, because the Office of Management and Budget limits requirements a Federal agency can impose. Currently, the Office of Management and Budget is considering changes which may correct some of the problems noted.

To expedite issuance of the report, formal, written agency comments were not obtained; however, the report was discussed with cognizant agency officials and their comments are included where appropriate.

Contents

ABBREVIATIONS

A/E	architectural-engineering
EPA	Environmental Protection Agency
GAO	General Accounting Office
GSA	General Services Administration
OMB	Office of Management and Budget

CHAPTER 1

PERSPECTIVE

The former Chairman of the Subcommittee on Investigations and Review, House Committee on Public Works and Transportation, asked us to review architect-engineering (A/E) fees paid under Environmental Protection Agency (EPA) grants. As a result of discussions with the Subcommittee staff, we determined

--whether current EPA A/E regulations and procedures assure that A/E services are obtained at fair and reasonable prices, including whether EPA and GAO have adequate authority to audit engineering firms' records;

--how much contracting methods, such as percentage-of-construction cost and percentage-of-direct cost, were used before July 1, 1975; and

--whether EPA can require grantees to renegotiate such contracts.

Payments to consulting engineers under EPA grants for municipal waste treatment plant construction represent major outlays. According to EPA officials, engineer fees comprise about 10 percent of total program costs. The Congress has provided over $19 billion for construction grants since 1972, and EPA has requested an additional $45 billion over the next ten years.

EPA REGULATIONS FOR PROCURING A/E SERVICES

Before December 1975, EPA did not have regulations governing the types of contracts grantees were allowed to use when acquiring A/E services. Instead, EPA had issued two guidance memos stating the Agency's preference for fixed price, per diem, and cost reimbursement contracts. The guidance memos, according to EPA, were not enforceable. As a result, grantees let contracts based on standard industry practice--percentage-of-cost type contracts.

Under these contracts, architects and engineers provided basic services and were generally paid a percentage of the costs to construct the facilities in return for designing them. For special services, such as technical inspection of construction, preparation of applications and support for Government grants, and assistance as expert witness in litigation, engineers were generally paid on the basis of the direct costs they incurred plus a percentage of those costs as compensation for overhead and profit. These methods of compensation did

not provide an incentive to reduce costs because profit escalated as cost escalated.

On May 9, 1975, EPA published proposed regulations establishing policies and procedures for the procurement of A/E services. Before finalizing the regulations, EPA considered about 360 comments, 180 of which were received from the engineering profession, and held meetings with representatives of those groups which submitted comments. EPA also coordinated the proposed regulations with the Office of Management and Budget (OMB) and the General Services Administration (GSA). GSA was responsible for coordinating Federal agency procurement regulations under Federal Management Circular 74-7 attachment O, on grantee procurement standards.

Final regulations were published on December 17, 1975. The regulations formalized previously issued guidance memos which prohibited the award of A/E contracts based on cost-plus-a-percentage-of-cost or a percentage-of-construction-costs, after July 1, 1975. Under the new regulations, grantees may award noncompetitive cost reimbursement, fixed price, and per diem contracts. A fixed price contract is appropriate only when the scope and extent of work to be performed can be clearly defined. All A/E contracts may be negotiated and cost reimbursement contracts must include a cost ceiling which cannot be exceeded without formally amending the contract. In addition, fixed price contract prices cannot be increased unless the scope of work is changed.

A/E firms are required to complete a standard cost review form and to submit it to grantees before contract negotiations. The cost review form document identifies the separate elements of estimated cost and profit and contains the firm's certification that the proposed costs are based on current, complete, and accurate cost data. The purpose of the form is to help EPA grantees review and evaluate contract proposals. EPA project officers are required to review all procurement actions for contracts over $100,000 and approve the grantee's compliance with appropriate procedures before award of the contract.

The regulations give EPA, GAO, and other cognizant agencies authority to examine records maintained by A/E firms. Contracts may be adjusted when the price to the Federal Government has been increased significantly because the A/E firm submitted data that was inaccurate, incomplete, or noncurrent.

SCOPE OF REVIEW

We performed work at EPA headquarters, Washington, D.C.; and at EPA regional offices in Atlanta, New York, and San Francisco. We selected several contracts in each region and contacted EPA project officers to determine how each contract was reviewed. We also reviewed other contract-related documents. Officials of selected State agencies, EPA grantees, A/E firms, and national professional engineering societies were also contacted for their views on the adequacy of the regulations.

CHAPTER 2

IMPROVEMENTS NEEDED IN CONTRACTING FOR ARCHITECTURAL-ENGINEERING SERVICES

The intent of the Environmental Protection Agency's A/E procurement regulations is to assure that grantees obtain engineering services at fair and reasonable prices. Although cost-plus-a-percentage-of cost or a percentage-of-construction-costs types of contracts are no longer being used, many weaknesses still exist in contracting for A/E services which raise questions as to the reasonableness of prices obtained. The following are the major problems.

--Many communities and EPA lack sufficient expertise to review cost and pricing data submitted by consulting engineers in support of price proposals.

--EPA and grantee reviews of procurement actions are inadequate.

--EPA lacks clear profit guidelines to use when evaluating cost and price proposals.

GRANTEES UNABLE TO ADEQUATELY REVIEW COST AND PRICING DATA

To a great extent, EPA relies on grantees to evaluate the reasonableness and allowability of cost and profit data submitted in support of proposed prices by A/E firms. Many grantees, especially smaller communities, cannot adequately perform this responsibility. EPA recognized this and provided in the regulations that grantees can hire qualified personnel to do cost reviews and charge personnel costs as allowable expenses under the grant.

A/E firms (1) summarize proposed costs and profit on EPA form 5700-41, (2) certify that the data is current, accurate, and complete, and (3) submit the data to the grantee. The grantee must review the submission and accept or adjust it during contract negotations.

The regulations proposed by EPA on May 9, 1975, called for the grantee to perform a detailed cost analysis for all contracts over $100,000 and to submit it to EPA for review and approval. This analysis involved examining, verifying, and evaluating the cost data and judgmental factors used in developing the overall price.

The final regulations, however, only require less comprehensive cost-review procedures, allowing grantees to limit their reviews to examinations of certified cost summaries

submitted by the engineering firms. Although not required, grantees may perform detailed cost analyses when necessary, but given the grantees' lack of ability, it is doubtful that such analyses will be performed unless EPA required it. In September 1976, EPA issued instructions on how to do cost reviews and analyses to its regional offices and grantees. These instructions, however, do not adequately address the problems noted in this report. No guidance was provided for the grantees to use in reviewing contracts of $100,000 or less.

To some extent, the less stringent cost review required by the final regulations resulted from a concern that grantees lacked adequate procurement expertise. In earlier reports 1/ we noted that many grantees, especially smaller communities, did not have employees with adequate qualifications to negotiate A/E contracts, while others with capable employees were not using their abilities in most instances. We also noted that in recognition that smaller communities lack procurement capability, one State solved the problem by (1) cosigning grantees' A/E contracts and (2) conducting contract negotiations.

EPA and State officials share our views that grantees are not adequately reviewing cost and pricing data submitted by A/E firms. The Director of EPA's Western Audit Division stated that most grantees were not evaluating cost and pricing data but were accepting the data based on the A/E firm's certification. Atlanta regional officials said that the new regulations had only been marginally successful in strengthening the grantees' position in contract negotiations. According to them, many grantees have continued to rely almost entirely on engineering firms and have little knowledge of the project. The officials believed this arrangement gave grantees very little opportunity to assess the reasonableness of the engineering firm's fees.

1/Reports on "Suffolk County Sewer Project, Long Island, New York: Reasons for Cost Increases and Other Matters" (CED-77-45, Mar. 22, 1977); report on effects of EPA's new regulations for procurement of A/E services on the municipal waste treatment program (RED-76-112, June 1, 1976); "Potential of Value Analysis for Reducing Waste Treatment Plant Costs" (RED-75-367, May 8, 1975); "Environmental Protection Agency's Construction Grant Program--Stronger Financial Controls Needed" (CED-78-24, Apr. 3, 1978).

In September 1976, in commenting on proposed guidance on profit levels in A/E contracts, the Director of EPA's Office of Audit reported that few grantees, except larger municipalities, have the expertise to properly evaluate the reasonableness of proposed quantities of direct labor hours and materials. About 80 percent of all construction grants awarded through December 31, 1975, were awarded to communities with populations of 25,000 or less. While such communities currently receive only about 20 percent of grant funds, the problem is significant especially when one considers that small communities will be receiving an increasing share of grant funds as the needs of large communities are satisfied.

In California, the Chief of Contract Administration of the State Water Resources Control Board said that because many grantees lack procurement expertise and fail to properly evaluate engineers' proposals, the State requires that consultants be hired to evaluate A/E cost and pricing submissions for fixed price contracts when the grantee cannot. Grantees are required to let cost reimbursement contracts, rather than fixed price, when the grantee cannot perform adequate reviews and does not wish to hire a consultant. EPA San Francisco regional officials also use this reasoning and have applied it to every State in the region.

Apart from the grantees' lack of expertise, EPA San Francisco region and California officials stated that the simple cost review required by EPA regulations is inadequate and that a cost analysis of contracts over $100,000 is necessary to assure the reasonableness of proposed costs. They stated that EPA or the State should perform the analysis if the grantee cannot and noted that the Federal Procurement Regulations require a cost analysis involving direct Federal procurement of engineering services over $100,000. EPA headquarters officials agreed, adding that public disclosure of A/E cost estimates should deter ill-conceived cost estimates.

EPA REVIEW OF GRANTEE PROCUREMENT ACTIONS IS INADEQUATE

Although EPA regulations generally apply to contracts for engineering services exceeding $10,000, EPA is not required to review procurement actions unless they exceed $100,000. Further, EPA had not defined procedures assuring that adequate and consistent reviews will be made, so, many contracts have not been reviewed. Of those contracts that have been reviewed, the documentation submitted by the grantee was insufficient and the regulations were not always followed.

Most A/E contracts are under $100,000; however, grantees are not required to submit documentation to EPA unless specifically requested to do so. Of the three EPA regions we reviewed, two require this documentation but do not review it in detail. The third region was implementing review procedures for contracts of $100,000 or less because regional officials believe a lack of control over engineering costs and profits exists for contracts in this category. It is obvious that EPA cannot determine whether a grantee properly evaluated the engineer's proposal or whether the proposed costs were reasonable if (1) grantees do not submit cost and pricing data to EPA on contracts of $100,000 or less and (2) EPA does not review the data at least on a sampling basis.

For those contracts over $100,000, regulations require that EPA review the contracts before award. The review process is not clearly defined. Review scope, therefore, varies among and within EPA regions. In EPA's San Francisco region, for example, the Chief of Grants Administration interpreted the review requirement as meaning that since EPA is not capable of assessing the reasonableness of the engineer's cost and pricing data, EPA must make certain that the grantee has the capability and does, in fact, negotiate contract terms before EPA will approve the contract. The EPA official added that all contracts over $100,000 are given full cost analyses when EPA does not have prior experience with the engineering firm. If, however, EPA has had experience with the engineering firm, only a cost review will be performed unless the review findings indicate further analysis is needed.

EPA New York and Atlanta regional officials said their procedures for reviewing A/E cost and profit proposals include examinations of cost estimates and support documents as well as selections of contract types. The review scope largely depends on the judgment of the EPA project engineer. For example, the evaluation of direct labor hours may be based on the project engineer's experience, comparison of the project with similar projects, and consultation with other EPA project engineers. The Director of EPA's Office of Audit, however, has stated that no regional office has expertise to adequately evaluate direct labor hours.

EPA officials acknowledge that the Agency lacks the needed staff capability to analyze A/E agreements. They said that most EPA engineers are sanitary engineers, but that various other engineering disciplines, such as electrical engineers, are needed to evaluate engineering proposals. Thus, EPA must rely on the professional judgment and integrity of the A/E firms.

We reviewed 33 A/E procurements, including 17 over $100,000, which EPA approved after March 1, 1976--the date all provisions of the regulations became effective. In nine of the contracts over $100,000, we found that either the procurement documentation submitted to EPA by the grantee was inadequate to assess the reasonableness of costs and pricing or EPA's reviews of this data were inadequate. Some of the major problems are included here.

1. The grantee did not submit data showing the method used to determine direct labor hours.

2. EPA did not obtain the required cost and pricing data.

3. EPA accepted per diem contracts where cost and profit components were not identified.

Further indications of weaknesses in EPA review of grantee procurement actions are shown in EPA Office of Audit reports on 56 preaward audits of engineering agreements completed before March 1977. Among other things the reports showed the following.

--Requests from regional staffs for preaward audits were made after the award of the A/E contract in 36 of the 56 cases.

--In 89 percent of these 56 preaward cases, the engineering agreement did not provide for renegotiation based on the results of the preaward audit.

--The types of contracts accepted were not always appropriate. Only 25 percent of the contracts reviewed were proposed as cost-reimburseable contracts; whereas, the EPA Office of Audit believed 80 percent of the contracts should have been because the probable cost of performance could not be clearly defined to justify a different contract type.

--Technical factors, on which engineering cost and price proposals were based, were not evaluated. The Office of Audit found instances of proposed costs based on unfounded estimates, excessive labor charges, and costs included as both direct and indirect costs. The reports stated that grantees were unable to evaluate technical factors and EPA had not developed procedures to evaluate those factors.

GAO and EPA's Office of Audit noted other weaknesses which further illustrate a need for improved procedures for reviewing A/E contracts. These weaknesses include

--access to records. Some contracts did not contain the required clauses granting access to A/E firm records for EPA, GAO, and other cognizant agencies.

--subcontracting. Some firms proposed subcontracting costs without obtaining proposals from the subcontractors, as required by the regulations for subcontracts over $10,000. One contract allowed for about 65 percent subcontracting, yet no subcontractor cost and pricing data was submitted by the grantee or requested by EPA reviewers.

--service charges. Some contracts included a provision to apply a service charge to certain direct costs incurred by the A/E firm. EPA concluded that this is a form of cost-plus-percentage-of-cost contracting and, therefore, is prohibited by the regulations.

EPA recognizes its inability to effectively evaluate engineering proposals and is taking corrective action. In June 1976, all regions were instructed to hire at least one cost analyst to review cost submissions. As of January 16, 1978, 14 full-time analysts had been hired.

LACK OF CLEAR PROFIT GUIDELINES

EPA has not clearly defined fair and reasonable profit for A/E services. As a result, profit percentages allowed on engineering contracts vary greatly and EPA regional officials and the Office of Audit believe guidance from headquarters is needed.

The Director of the Western Audit Division said that the profit provisions in the regulations are unclear and have been interpreted differently across the Nation. We found that EPA's

--New York region uses 10 to 18 percent as an acceptable profit range;

--Atlanta region allows a maximum profit of 15 percent but may allow greater profits provided additional justification is provided; and

--San Francisco region formerly referred its grantees to profit guidelines in the Federal Procurement

Regulations but, at the time of our review, was implementing maximum profit criteria of 15 percent.

Officials said differences in allowed regional profit levels can cause problems with engineering firms whose clients cross regional lines.

In audit reports on 56 engineering contracts EPA's Office of Audit expressed similar concerns. The reports said proposed profits ranged from 5 to 33 percent on fixed-price contracts, and fees ranged from 7 to 19 percent on cost reimburseable contracts. The Office of Audit concluded that without a formal, agencywide policy on profit, EPA grantees cannot challenge proposed engineering profits from a position of strength. Further, profit determinations will continue to be inconsistent from region to region.

EPA has drafted proposed profit guidelines on several occasions, but they were not implemented because EPA believed that profits varied too greatly to establish a normal profit range. We believe the wide variation in profits demonstrates the need for profit guidelines. EPA regional and Office of Audit officials also support the need for profit guidelines. Further, engineering firms also favor development of fair profit guidelines by EPA headquarters so they do not have to deal with individual regional and local opinions as to fair and reasonable profits.

EPA's failure to provide uniform guidance regarding fair and reasonable profits to be allowed results in significant inconsistencies between regions. We believe that profit guidelines are needed because grantees lack experience negotiating professional service contracts. Clear profit guidelines would help to compensate for this lack of experience, assuring that grantees obtain engineering services at fair and reasonable prices.

CONCLUSIONS

Because of the December 1975 regulations, EPA grantees no longer award contracts based on a percentage of construction costs. In addition, current contracts include compensation ceilings. EPA still lacks assurance, however, that prices paid for A/E services are fair and reasonable because both grantees and EPA cannot adequately evaluate proposed engineering contract costs and profits.

There are two reasons for this inability to evaluate costs and profits.

1. EPA and the grantees lack expertise in analyzing quantitative factors in A/E proposals, such as direct labor hours and materials. A permanent solution to this problem must be found and could involve the use of other government agencies, help from the private sector, improved inhouse capability, or combinations thereof. EPA is, however, trying to resolve the situation.

2. EPA does not have a system for reviewing proposals and completed contracts. Consequently, the quality and depth of reviews varies among regions, causing variations in fees paid for A/E services under contracts. As part of a system of review, EPA needs to establish guidelines defining fair and reasonable profits. Exceptions allowing greater than normal profits could be provided for in the guidelines. If this is done, however, the circumstances under which exceptions would be allowable and the method of approving exceptions should be clearly identified in the guidelines.

EPA also needs procedures on what constitutes adequate reviews for contracts under and over $100,000. Currently, the regulations do not require EPA reviews of contracts under $100,000, even though they (1) comprise the majority of engineering contracts awarded and (2) will increase in number as more small communities become eligible for construction grants. Reviews of contracts over $100,000 are inconsistent among regions because of the lack of procedures.

RECOMMENDATIONS TO THE EPA ADMINISTRATOR

To achieve needed improvements in contracting for A/E services, we recommend that the Administrator, EPA

--develop guidelines for grantees to use in reviewing A/E contract proposals of $100,000 or less. Such guidelines should include, but not be limited to, procedures for (1) insuring that adequate cost data is submitted by the A/E firm for review, (2) analyzing the reasonableness of A/E cost submissions, and (3) insuring EPA, GAO, and other responsible agencies' access to A/E Firms' records as required in the regulations.

--emphasize to grantees that hiring personnel to do cost reviews is permitted under the regulations as an allowable cost.

--revise EPA guidance to clearly define the procedures to be used in reviewing A/E contract proposals over $100,000. EPA should insure that the scope of its review procedures are clearly spelled out so that adequate cost data is obtained and reviewed, and required access to records and defective pricing clauses are included in A/E contracts.

--develop and issue guidance on fair and reasonable profits to be allowed in A/E contracts.

--develop a program to review A/E contracts under $100,000, on a selected basis to determine the adequacy of grantee reviews of A/E proposals and to periodically revise the guidelines developed for review of such proposals, if necessary.

AGENCY COMMENTS AND OUR EVALUATION

To expedite issuance of the report, formal, written Agency comments were not obtained; however, the report was discussed with cognizant Agency officials and their comments are included where appropriate.

EPA agreed that more guidance is needed to insure that grantees obtain engineering services at fair and reasonable prices. The Agency indicated, however, it would be difficult to implement the recommendations because Federal Management Circular 74-7 (later reissued as OMB Circular A-102), attachment O, limits procurement requirements a Federal agency can impose on grantees. The circular's objective is to establish standards for consistency and uniformity among Federal agencies administering grant programs so that State and local governments will not have to comply with conflicting requirements.

EPA said attachment O does not have specific, effective guidance. Recognizing this, EPA obtained a "temporary deviation" from OMB, allowing the Agency to issue regulations that were more stringent than the standard requirements in the attachment. Currently, OMB is considering revisions to Circular A-102, attachment O, which may correct some of the problems noted.

We believe EPA should support OMB efforts to achieve simplification in the administration of grant programs in State and local governments. EPA also has an obligation, however, to issue administrative requirements to maintain the fiscal integrity of the multibillion-dollar grant program, particularly since grant funds are expended by grantees

primarily through contracts with third parties. Thus, if the revisions to Circular A-102, attachment O, cannot correct the weaknesses we noted, EPA should seek further OMB deviations to issue guidance for correcting these weaknesses.

CHAPTER 3

MANY PRE-JULY 1975 CONTRACTS CANNOT BE RENEGOTIATED

Before July 1, 1975 when EPA's policy changed, most grantees based contracts for A/E services on fee determination methods which are now prohibited. EPA cannot legally require grantees to renegotiate many of those still active contracts which were let under grants awarded before July 1, 1975. EPA can and does, however, require renegotiation of contracts or portions of contracts that were let before that date but which were or will be funded by grants awarded after July 1, 1975. Voluntary renegotiation is possible but has been infrequent according to EPA officials.

BANNED CONTRACTING METHODS WERE PREVALENT BEFORE EPA PROHIBITED THEM

EPA headquarters and regional officials said that before EPA issued regulations prohibiting them, the use of cost-plus-percentage-of-cost and percentage-of-construction-cost contracts were very prevalent in contracting for A/E services. According to the officials, these methods of reimbursement were used in more than 80 percent of all contracts awarded by EPA grantees.

EPA officials said that before July 1, 1975, it was also common practice for grantees to award open-ended contracts, establishing no ceiling on fees which could be paid without formally amending the contract. These officials estimated that over 95 percent of A/E contracts were open ended.

We could not determine the number and dollar values of contracts as of July 1, 1975, or of current contracts because needed information was available only at grantee locations. As of May 23, 1977, however, there were about 8,600 active EPA construction grants nationwide. Of these grants, about 2,500 were awarded before July 1, 1975. Most of the A/E contracts awarded under these 2,500 grants probably contained the banned contracting provisions and provided for no ceiling on fees.

Our analysis of selected contracts

We examined provisions of 91 contracts for A/E services awarded under 75 selected EPA grants from July 1, 1974, through June 30, 1975. Of the 91 contracts, 72 provided for both basic and special engineering services, 8 provided for only basic services, and 11 provided for only special services.

The following chart shows the number of basic and special service contracts we examined, and the percent that reimbursed A/Es based on methods of fee determination currently prohibited by the regulations.

Schedule of Selected A/E Contracts
Under Grants Awarded Before July 1, 1975

	New York Region	Atlanta Region	San Francisco Region
Basic Services:			
Number of contracts reviewed	27	25	28
Percent based on now-banned provisions	89	76	46
Special Services:			
Number of contracts reviewed	28	22	33
Percent based on now-banned provisions	86	64	27

With few exceptions, cost ceilings had not been established in the contracts we reviewed. We asked San Francisco regional officials about the low percentage of contracts based on banned provisions; however, they could not explain this low percentage.

Our analysis showed also that grantees followed guidelines developed by various national and State engineering societies in setting fees. The most commonly used fee curves and schedules were those of the American Society of Civil Engineers.

NO LEGAL BASIS EXISTS FOR RENEGOTIATION

Office of Management and Budget Circular A-102, attachment O, paragraph 3(c)(4), has prohibited the recipients of Federal grants from using the cost-plus-percentage-of-cost method of contracting since July 1, 1972. The Circular, however, was not and is not legally binding on the agencies, representing an expression of Executive Branch policy. The prohibition does not affect agency grantees until agencies have implemented this restriction. EPA did not implement the prohibition until July 1, 1975. EPA cannot, therefore, require its grantees to renegotiate many now-banned contracts let under grants awarded before the date. EPA can and does, however, require grantees to renegotiate contracts or portions of contracts let before July 1, 1975, but which were or will be funded by grants awarded after that date. Many grantees, for example, let comprehensive A/E

contracts to cover all three phases of construction--planning, design, and construction of treatment facilities--as a matter of course. EPA will fund only one step of the process at a time. Thus, while planning of the treatment facility under the contract may be underway and is funded by a grant awarded before July 1, 1975, the design and construction portions of the contract have not been started. Consequently, when grantees apply for grants to cover design and/or construction of contracted facilities, EPA requires renegotiation of A/E contracts.

Voluntary renegotiation is possible but is has been infrequent according to EPA officials. These officials informed us that the renegotiation of the thousands of banned contracts--those active when the policy change went into effect--would have been a major undertaking, involving no predictable benefits to the Government. Such a renegotiation program (1) would have been costly for EPA to administer, (2) would have taken personnel away from current grant activities, (3) and would have possibly slowed down the construction grants program. EPA officials also said that the records of A/E firms may not have been reliable enough for contract renegotiation purposes and that renegotiation could have resulted in higher, rather than lower, contract prices.

EPA AND GAO ACCESS TO RECORDS OF A/E FIRMS

EPA and GAO have had access to the records of grantee contractors involved in the treatment works construction program since February 28, 1973.

Both EPA and GAO were granted access by 40 Code of Federal Regulations 35.935-7, which originally provided:

> "Any construction contract must provide that representatives of the Environmental Protection Agency and the State will have access to the work whenever it is in preparation or progress and that the contractor will provide proper facilities for such access and inspection. The contract must also provide that the Grants Officer, the Comptroller General of the United States, or any authorized representative shall have access to any books documents, papers, and records of the contractor which are pertinent to the project for the purpose of making audit, examination, excerpts and transcriptions thereof."

This section of the regulations was amended on December 29, 1976, according to EPA, to clarify that it is the grantee's responsibility to assure that access is provided.

After February 28, 1973, therefore, all grantee contracts should have contained access-to-records provisions. No court has answered the question of whether in the absence of such provisions GAO or EPA have access to contractor records. EPA, however, has been gaining access to contractor records where access-to-records provisions do not exist. EPA's Office of General Counsel is studying the matter, and their views and ours will be forwarded to the Subcommittee at a later date, as requested.

CONCLUSIONS

Banned contracting methods for A/E services were prevalent before EPA prohibited them, effective July 1, 1975, on the grounds that they provided no incentive to reduce costs. Because it does not have the authority, however, EPA cannot legally require grantees to renegotiate contracts let before this date unless grant funds are awarded subsequently. Voluntary renegotiation is possible, but has been infrequent, according to EPA officials. Further, EPA believed the administrative costs of renegotiation would have been high. Renegotiation could have resulted in increased, rather then decreased, contract prices.

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